# EXHIBIT 10

DEFENDANT'S EXHIBIT
Black-1
8/14/08

UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

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| In re CREDIT SUISSE – AOL SECURITIES LITIGATION | Case No. 1:02 CV 12146 (Judge Gertner) |
| This Document Relates To: ALL ACTIONS | |

**EXPERT REBUTTAL REPORT OF BERNARD S. BLACK**

## I. Scope of Report

I have been retained by the law firm of Kaplan Fox and Kilsheimer LLP on behalf of the plaintiffs, to provide expert opinions on the likely importance to investors of disclosure by defendant Credit Suisse First Boston (CSFB) of the true opinions of its analysts, Jamie Kiggen and Laura Martin, about the expected financial performance of AOL Time Warner (AOLTW), during the class period from AOL's acquisition (the "Merger") of Time Warner Inc. ("Time Warner"). References to AOL and TW for periods after the Merger are to the AOL and Time Warner divisions of AOLTW. I am submitting this report in response to the expert reports of John Deighton and Rene Stulz.

## II. Qualifications

I am Professor of Law and Hayden W. Head Regents Chair for Faculty Excellence at the University of Texas Law School, director of the Center for Law, Business and Economics at the University of Texas Law School, and Professor of Finance at the University of Texas, McCombs School of Business. My curriculum vitae is attached as Appendix A to this Report. I have taught courses in, among other subjects, Corporate Finance, Corporations, Corporate Acquisitions, and Securities and Capital Markets Regulation.

I am an author or coauthor of Ronald Gilson & Bernard Black, *The Law and Finance of Corporate Acquisitions* (2d ed. 1995 and supplement 2003-2004); Bernard Black, Reinier Kraakman & Anna Tarassova, *Guide to the Russian Law on Joint Stock Companies* (1998); Bernard Black, *Fundamentals of Negotiating and Drafting Acquisition Agreements* (ALI-ABA 1998); and a large number of professional articles, principally in the areas of law and finance, corporate governance, corporate acquisitions, corporate finance, and corporate and securities law. My professional articles are listed in my curriculum vitae.

I have been at the University of Texas since 2004. Prior to that, I taught at Stanford Law School from 1998-2004, where I was George E. Osborne Professor of Law, and at Columbia Law School from 1988-1998, where I was Associate Professor of Law (1988-1991) and Professor of Law (1991-1998). I served as Counsel to Commissioner Joseph Grundfest of the Securities and Exchange Commission from 1987-1988 and practiced law from 1983-1987 in the mergers and acquisitions group at Skadden, Arps, Slate, Meagher & Flom. From 1982-1983, I was a law clerk to Judge Patricia M. Wald of the United States Court of Appeals for the District of Columbia Circuit. I received a J.D. degree from Stanford Law School in 1982.

In addition to my scholarly writing and experience as a practicing lawyer, I have been an outside director of two public companies: Kookmin Bank from 2003-2005 (largest Korean commercial bank, listed on New York Stock Exchange), where I was a member of the risk management and management strategy committees; and Homeland Holding Corp. from 1989-1996 (supermarket chain, with publicly held debt and privately held equity), where I was chair of the audit committee. I am managing director and part-owner of Social Science Electronic Publishing, Inc. (SSEP), an electronic publishing company which runs the Social Science Research Network (www.ssrn.com). I helped to create in 2002, and directed from 2002-2004, the Directors Consortium training program for public company directors (jointly sponsored by Stanford Law School, University of Chicago Business School, and Wharton Business School).

I consider myself to be qualified to act as an expert in the fields of corporate finance corporate and securities law and practice; including the potential impact of analyst estimates on share prices. I have served as an expert witness in all of these areas, and have testified for both plaintiffs and defendants.

I am being compensated for my expert report in this case at my usual hourly rate of $800. A list of cases that I have testified in or prepared expert reports in is attached as Appendix B.

## III. Documents Reviewed and Assumptions

### A. Documents Reviewed

In preparing this report, I have reviewed selected portions of the following sources of information:

(i) the Second Amended Complaint in this case;

(ii) Annual reports on Form 10-K, and annual reports to shareholders by AOL and TW for 2000 Quarterly Reports on Form 10-Q, annual report on Form 10-K, and annual report to shareholders by AOLTW for 2001;

(iii) Selected press releases, transcripts of analyst conference calls, news stories, and analyst reports concerning AOL, Time Warner, AOLTW, and the overall advertising market during the second half of 2000 and during 2001;

(iv) Depositions of Laura Martin and Jamie Kiggen, and exhibits to those depositions;

(v) Various internal CSFB emails, including those cited in the complaint.

(vi) Expert Reports by John Deighton (May 1, 2008), and Rene Stulz (May 1, 2008) on behalf of Defendants; and

(vii) Other discovery documents provided to me by counsel.

My review of the factual record is ongoing. I may supplement or modify the opinions expressed below based on additional information, including information provided through discovery requests to which defendants have yet to respond, and also to respond to defendants' experts.

### B. Assumptions

I have been instructed by plaintiff's counsel to make the following factual assumptions, which are consistent with the factual record available to me:

(i) During the class period, Laura Martin did not believe that AOLTW would meet either its guidance or CSFB's public estimates for revenue and EBITDA, due to the declining market for both "traditional" (not online) and online advertising.

(ii) While Laura Martin's expertise was primarily on the TW side of AOLTW, she was informed about and prepared forecasts for AOLTW as a whole, which showed lower AOL EBITDA than CSFB's published forecasts.

(iii) At least as early as March 15, 2001, Jamie Kiggen did not believe that AOLTW would meet either its guidance or CSFB's public estimates for revenue and EBITDA.

## IV. Summary of Expert Opinions

At the time of the Merger, AOL possessed a valuable but maturing business. AOL had an important business opportunity to increase its revenue from online advertising and other forms of electronic commerce. But it also faced serious threats from broadband internet access, which would compete with and could supplant AOL's business model, which was based on dial-up internet access; and the emergence of new competitors. Beginning in the second half of 2000, both AOL and TW faced additional challenges, both before and after the Merger, due to a slowdown in both online and traditional advertising.

This case principally involves the question of what AOLTW's share price would have been during the class period if CSFB's analysts, Jamie Kiggen and Laura Martin, had said publicly what they believed or had reason to believe privately as early as the date of the Merger in January 2001. Their private views included, at various times that: the advertising slowdown was likely to have a bigger impact on AOLTW than it was publicly admitting; AOLTW could not make up on the AOL side the shortfall that Laura Martin expected on the TW side; the advertising slowdown was not limited to traditional advertising; TW was taking actions which reduced the quality and sustainability of earnings; the growth rates and EBITDA multiples needed to generate CSFB's $75 target share price were unrealistic on both the AOL side and the TW side; AOLTW was unlikely to meet its

aggressive revenue and EBITDA projections for 2001; and AOLTW was still more unlikely to meet its .projections for 2002-2005.

This Report addresses AOLTW's prospects, CSFB's internal and public views about those prospects, and the reasonableness of its public views, during the class period.[1]. All references in this Report are to calendar (rather than fiscal) periods, unless specified otherwise. I reserve the right to add to or modify these opinions as additional facts become available.

If CSFB had publicly provided forecasts and opinions on AOLTW consistent with the private views of Laura Martin and Jamie Kiggen, and the information available to them, this would likely have been important to investors in forming an overall assessment of AOLTW's growth prospects and value. Conversely, CSFB's public forecasts and opinions on AOLTW were, in important respects, unreasonable given the beliefs of Jamie Kiggen and Laura Martin and the information available to them.

## V. Disclosure of CSFB's Internal Information Would Have Been Important to Investors

In the first half of 2001, investors were generally aware of a slowdown in traditional advertising, but there were conflicting views on how severe the slowdown would be. Beginning in the second quarter of 2001, investors were also generally aware of a slowdown in online advertising, but there were again conflicting views on severity. AOLTW, however, was stating that it was "highly confident" in its revenue and EBITDA projections, and claiming it saw only a mild slowdown in traditional advertising and no slowdown in online advertising. Many analysts, including Martin and Kiggen, were publicly agreeing with AOLTW's projections.

[1] The detailed analysis below focuses on the period through Sept. 25, 2001, when AOLTW reduced its 2001 and 2002 guidance.

An important part of the value added by good analysts, and the potential for their views to affect share prices, comes not from their access to information, but from their ability to collect and "analyze" public information in a way which provides new insight to investors.

Investors would form their views on AOLTW's value based on all available information. Jamie Kiggen and Laura Martin were both highly respected analysts. Statements by them, consistent with their private beliefs and information, would likely have affected the overall mix of information available to investors, and thus would likely have affected AOLTW's share price.

AOL's past financial results and forward-looking guidance persuaded investors to value AOL at extraordinary multiples of revenue and EBITDA. These multiples reflected investors' belief that AOL would grow rapidly for a long period of time. Even a modest slowdown in AOL's expected growth rate would likely have affected those multiples and thus AOLTW's share price. In effect, a slowdown in AOL growth would be doubly important, because it would affect both the base to which the AOL multiple was applied, and the multiple. A similar multiplier effect could exist for AOLTW as a whole.

In July 2001, CSFB became aware, through a source within AOL, of "medium severity" layoffs in AOL's Business Affairs unit, which originated most of AOL's advertising and commerce revenue ("Ad-Com Revenue"). This information should have caused CSFB to reassess its estimates of AOL's Ad-Com revenue, since substantial layoffs are inconsistent with the rapid growth at AOL that CSFB was expecting.[2]

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[2] I assume here that this information relates to a layoff of around 1,000 people which was publicly reported On August 13, 2001 by the *Wall Street Journal* and then confirmed by AOL about a week later. Prof. Stulz, in his report, states that he was instructed by defense counsel to assume that this information related to a tiny layoff which was publicly reported on July 11 in the *Washington Post*, which involved only about 30 people "spread around the country," rather than the much larger layoff which became public the next month. Which layoff CSFB had knowledge about is a factual question, which neither of us can resolve.

Also in July 2001, CSFB became aware, through the same source, of an internal investigation into accounting irregularities within the Business Affairs unit. Assuming that this information exceeded what was publicly known concerning AOL's dealings with Purchase Pro, this knowledge could be important to investors.[3] Beyond the substance of the internal investigation, the mere fact of an additional investigation into AOL's accounting could call into question the integrity of AOL's financial reporting generally, and thus could affect the value of AOLTW shares.

## V. CSFB's Reports

AOLTW's ability to meet its guidance on 2001 revenue and EBITDA depended on both very rapid growth in the AOL division *and* strong growth in the TW divisions. At early 2001, CSFB was projecting that AOL revenue would grow 26%, from $7.7B to $9.7B, and AOL EBITDA would grow 49%, from $2.35B to $3.51B, including even faster growth in Ad-Com Revenue, in the teeth of a declining ad market and the collapse of some of AOL's important customers.[4] As I discuss below, these were aggressive and likely unattainable projections. If the TW divisions performed as Laura Martin expected and stated internally within CSFB, it was not plausible that AOL could make up the shortfall by growing even faster than this, so that AOLTW would meet its overall revenue and EBITDA guidance.

CSFB's apparent position is that Laura Martin was an expert on TW, but not on AOL, while Jamie Kiggen was the expert on AOL (but not on TW), and published combined forecasts which he believed were achievable for AOLTW as a whole. CSFB does not claim that Kiggen had expertise

[3] Prof. Stulz, in his report, states that he was instructed by defense counsel to assume that this information related to "AOL's internal investigation of its relationship with Purchase Pro," which had already been publicly reported. Stulz Report ¶ 73. However, as AOLTW's later restatements show, AOL had improperly booked advertising revenues and engaged in other improper or suspect transactions with a large number of counterparties. Whether the tip related to Purchase Pro or to these other transactions is a factual question, which neither of us can resolve.

[4] CSFB report on AOL Time Warner (April 10, 2001).

on TW. One might therefore expect Kiggen to take Martin's TW numbers -- both her projections and her multiples -- add his best estimate for AOL, and see what they add up to. Kiggen instead reported higher numbers and multiples for TW than Martin had provided to him *for TW*.

I would also expect Kiggen to update his own numbers for AOL and thus for AOLTW as a whole, as new information came in. Kiggen didn't do that very well either. I have available two detailed sets of CSFB projections in the first half of 2001: a Fidelity presentation on Jan. 24, 2001 ("Fidelity Report"), shortly before AOL reported 2000 full-year numbers, and a public report on April 10, 2001, shortly before AOL reported 1Q 2001 numbers. A close look at these reports provides evidence that in important respects, they were not plausible when written, nor were they appropriately revised when they soon turned out to be too optimistic, relative to both AOLTW's performance and Kiggen's and Martin's private views.

These sources of evidence support the view that Kiggen was *not* reporting an honest, combined Kiggen-Martin view of AOL's or AOLTW's prospects of value.

I will discuss the Fidelity Report first, focusing on the period from 2001-2005.[5]

**A. Revenue**

Consider first AOL revenue. Kiggen provided Fidelity with a 2000E estimate for AOL total revenue, subscription revenue, and Ad-Com Revenue. For total revenue, he estimated $7,959 (all amounts in $millions). The first 3 quarters of 2000 were already known, so we can back into an

[5] In some cases, numbers are not quite internally consistent within this document, but the differences are small and do not affect my analysis. I generally (i) use numbers from "overview" sheets, rather than numbers from detail sheets, when the two differ; and (ii) use numbers with more digits rather than rounded numbers with zeros at the end, when the two differ. The Fidelity Report includes some more conservative projections, which allowed for a shortfall in advertising revenue or subscription revenue, concentrated in 2002. Those downside scenarios do not appear in CSFB's published reports.

implied 4Q 2000 revenue estimate of ~~$2,315~~ 2,208. Was that plausible given what Kiggen and Martin knew and believed?

Table 1 shows AOL's revenue by quarter for 2H 1999 and for 2000. I have placed a thick vertical line between 1Q and 2Q 2000; this line reflects the bursting of the NASDAQ bubble after March 2000. There is a clear post-bubble slowdown, with quarter-over-quarter (Q/Q) growth of ~~3.9%~~ 4.4% in 2Q 2000 and ~~3.2%~~ 2.4% in 3Q 2000. Against that background, Kiggen was projecting ~~an absurd~~ a highly optimistic ~~19%~~ 11.8% Q/Q growth rate.

AOL's quarterly growth did indeed tick up to 5.9% in 4Q 2000 (due, we learned in hindsight, to aggressive number fudging); but this was not close to Kiggen's figure.[6] A week later, AOL reported 4Q 2000 revenue of $2,059M, ~~a shocking 11~~ 7% short of Kiggen's estimate.[7]

**Table 1: AOL Reported Revenue, Kiggen Projections, and Backlog**

Amounts in $ millions. Q/Q growth is percentage growth in revenue for the quarter, compared to the preceding quarter. Kiggen projections (shaded cells) are computed based on actual results for first 3 quarters of 2000 and full year projections included in CSFB Fidelity Report (Jan 24 2001).

1,477 1,633 1,847 1,929 1,975

| Period | 3Q 1999 | 4Q 1999 | 1Q 2000 | 2Q 2000 | 3Q 2000 | 4Q 2000 |
|---|---|---|---|---|---|---|
| **Total Revenue** | 1,463 | 1,618 | 1,814 | 1,885 | 1,945 | 2,059 |
| ***Q/Q growth (%)*** | *5.7%* | *10.6%* | *12.1%* | *3.9%* | *3.2%* | *5.9%* |
| **Kiggen projection** | | | | | | 2,315 |
| **Kiggen projected growth** | | | | | | 19.0% |

2,208
11.8%

10.6% 13.1% 4.4% 2.4%

CSFB also projected that AOL, despite its slower post-bubble growth, would soar to 37% year-over-year (Y/Y) revenue growth in 2001, and then average 30% over 2002-2004. Yet subscription revenue was slowing as the dial-up business matured, and the advertising slowdown was intensifying. Even if AOL had been largely immune from this slowdown so far, as it claimed,

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[6] ~~In a Feb. 1, 2001 report, published soon after AOLTW released 4Q numbers, Kiggen stated that AOL revenue was $2.1B, versus his $2.2 billion estimate. I am unaware of a published source from which I can verify this $2.2B figure. Even if his estimate for 4Q 2000 revenue was $2.2 billion, versus the $2.315 estimate embedded in the Fidelity presentation, this is still an unrealistic 13.1% quarterly growth rate.~~

[7] Prof. Deighton comments that much of AOL's revenue came from subscriptions, which provided a predictable source of revenue, not subject to fluctuations in the advertising market. Deighton Report ¶ 22. Subscription revenue was

that happy outcome could hardly be expected to continue indefinitely. Put those two elements together (I discuss each separately below), and CSFB's revenue projections are not plausible.

**B. Market Share**

In the medium term, CSFB estimated a sharp slowdown in online advertising, from 78% growth in 2000 to 8% in 2001, and then roughly 25% annual growth, beginning in 2002. A natural expectation, as the online advertising market matured and AOL's competitors learned how to provide ads, would be for AOL's market-leading share to shrink. Kiggen instead projected that AOL's market share would jump from 27% in 2000 to 41% in 2001, and then keep climbing, to 60% in 2005. See Table 2.

This was highly unlikely. It required AOL to grow rapidly in 2001, while all other online advertising was shrinking, and then follow up this performance by capturing over 70% of all growth in online advertising for the next four years.

**Table 2: AOL and National Ad-Com Revenue**

Amounts in $ millions. Y/Y growth is percentage growth in category for the year, compared to the prior year. Kiggen projections are from Fidelity Report (Jan, 24, 2001). Ad-Com Revenue is "old series", the numbers were restated by AOLTW to be more inclusive beginning with its public report for 4Q 2000 ("new series").

| **Period** | **2000** | **2001** | **2002** | **2003** | **2004** | **2005** |
|---|---|---|---|---|---|---|
| **Ad-Com Revenue** | 2,132 | 3,500 | 5,100 | 7,050 | 9,600 | 12,850 |
| ***Y/Y growth (%)*** | | *64%* | *46%* | *38%* | *36%* | *34%* |
| **Total Online Ad Market** | 8,000 | 8,640 | 10.800 | 13,824 | 17,280 | 21,427 |
| *Total Y/Y growth* | 78% | 8% | 25% | 28% | 25% | 24% |
| *AOL share of total* | 27% | 41% | 47% | 51% | 56% | 60% |
| *AOL share of market growth* | | 214% | 74% | 64% | 74% | 78% |

**C. CSFB's April 2001 Report**

On April 10, 2001, CSFB published a major report on AOLTW, which included a target price of $75 per share; 2001 estimated 2001 revenue of $41.2B; and 2001 EBITDA of $10.9B.

62% of total AOL revenue for 3Q 2000. This only makes it more puzzling how Kiggen could be so far off.

AOL had fallen far short of Kiggen's revenue estimates for 4Q 2000, included in the Fidelity projections. He therefore reduced his 2001 estimates for AOL revenue by $1.2B. Yet he *increased* estimated TW revenue by $800M, so that overall AOLTW revenue dropped by only $400M.

It is hard to see how this change in TW revenue was either honest or reasonable. Laura Martin was the TW expert, and she was trying to bring the TW numbers down, not up. Moreover, the general investor view of 4Q 2000 was that AOLTW had disappointed especially on the TW side.[8]

For AOL, lower revenue usually means lower profit. AOLTW's refusal to disclose AOL's advertising backlog, after backlog had been flat in 3Q 2000, provided an additional warning sign of slower Ad-Com growth.[9] But CSFB nonetheless raised its EBITDA estimate from 3,443 to $3,510 for 2001, in the face of a major AOL revenue shortfall in 4Q 2000 (relative to Kiggen's January estimate), and strong evidence by this time of a contraction in online advertising.[10] This was neither reasonable nor consistent with Kiggen's and Martin's private views.

On April 19, 2001, AOLTW released its 1Q 2001 results, which came in well below CSFB's public estimates for the AOL division. Table 3 shows the CSFB forecast, and AOL's results.

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[8] See, for example, *AOL Down - Investors Skeptical About Growth Prospects*, Reuters News, Feb. 1, 2001 (quoting ABN Amro analyst Arthur Newman as saying the "AOL numbers were fine, but the Time Warner numbers were rather disappointing").

[9] Prior to 4Q 2000, AOL had regularly reporting its backlog for future Ad-Com revenue based on long-term contracts. This backlog had shown rapid growth through 2Q 2000. However, backlog had flattened out in 3Q 2000 at $3B, and AOL stopped reporting it altogether in 4Q 2000. Kiggen had seen the growing backlog as "important" in the past. DLJ Securities, AOL Reports High Quality March Quarter Results (Apr. 19, 2000) ("Importantly, the backlog of advertising and commerce revenue grew by $300 million in the quarter, to $2.7 billion). The CSFB reports do not discuss the implicaitons of AOLTW's ceasing to report backlog. In fact, the backlog dropped in 4Q 2000, as one might have surmised

[10] By March 2001, CSFB expected online advertising to shrink by 20% in 2001, versus its January estimate of 8% growth.

**Table 3: CSFB's Estimates for 1Q 2001 vs. AOL Results**

Amounts in $ millions. Q/Q growth is percentage growth in category for 1Q 2001, versus 4Q 2000. Kiggen revenue and EBITDA projections are as published on Apr. 10, 2001; Ad-Com Revenue and subscription revenue estimates are from CSFB Report on AOL (Apr. 18, 2001); other revenue estimate is computed as (total revenue - Ad-Com Revenue - subscription revenue). Ad-Com Revenue is "new series", after redefinition by AOLTW beginning in 4Q 2000.

| Item | Revenue | EBITDA | Ad-Com Revenue | Subscriber Revenue | Other Revenue |
|---|---|---|---|---|---|
| **Kiggen Q1 Estimate** | 2,210 | 720 | 744 | 1,300 | 166* |
| ***Q/Q growth*** | 7.3% | 10.4% | 8.5% | 5.4% | 18.6%* |
| **AOL Actual** | 2,125 | 684 | 721 | 1,252 | 135 |
| ***Q/Q growth*** | 3.2% | 4.9% | 5.1% | 1.5% | (-3.6%) |

* approximate, because estimate is based on possibly rounded estimate for subscription revenue.

Publicly, CSFB called these results a "Positive Surprise," in its headline for its report on AOLTW's results. In fact, CSFB's revenue and EBITDA estimates had been unreasonably high and inconsistent with Kiggen's and Martin's private views before this announcement, and could only be even more so now. Yet CSFB's public estimates did not change.

### D. Implications of Slower AOL Growth for Enterprise Value

The slowdown in AOL's growth over the three post-bubble quarters from 3Q 2000 through 1Q 2001 had large implications for AOLTW's enterprise value. I will assume, with Kiggen, that due to expected high growth, AOL EBITDA deserved in January 2001, a 62x multiple, while the rest of TW deserved an 18x multiple.[11] By that measure, ignoring for simplicity adjustments for minority interests and such, Kiggen's April 2001 published estimates provide the following overall enterprise value (in $ millions):

AOL: 62 x $3,510 = $217,620
TW: 18 x $7,390 = $133,020
AOLTW Total: = $350,640
Per share (4,725 diluted shares outstanding): $74

[11] The TW assumption is doubtful. Kiggen arrived at the blended 18x multiple for TW by *raising* Martin's estimated multiples, even though she was the TW expert, and she was concerned about TW at a number of levels, including advertising spending, earnings quality, and capital intensity.

This is quite close to CSFB's published estimate.[12]

But a 62x multiple would no longer be appropriate once AOL's growth slowed post-bubble. AOL's enterprise value would thus suffer a double hit -- lower EBITDA and a lower multiple. Table 4 shows AOLTW enterprise value at different possible multiples, assuming AOL continued to grow EBITDA at its post-bubble rate. The double hit from lower EBITDA and lower multiple would have a large effect on AOLTW's enterprise value.[13]

**Table 4: Revised AOL and AOLTW Valuation Estimates**

Estimated AOL, TW, and AOLTW enterprise value, based on AOL EBITDA estimate from constant growth forecast (see previous table); AOL multiples are as shown; and TW EBITDA estimate and 18x multiple are from Kiggen April 10, 2001 report. Amounts in $ millions, except multiples and per share amounts.

| Cells show enterprise value | 2001 EBITDA | AOL multiple | | | | |
|---|---|---|---|---|---|---|
| | | 40 | 45 | 50 | 55 | 62 |
| AOL | 2,970 | 118,800 | 133,650 | 148,500 | 163,350 | 184,140 |
| TW (18x multiple) | 7,390 | 133,020 | 133,020 | 133,020 | 133,020 | 133,020 |
| AOLTW | 10,360 | 251,820 | 266,670 | 281,520 | 296,370 | 317,160 |
| Per share | | $53.30 | $56.44 | $59.58 | $62.72 | $67.12 |

After CSFB's virtual non-reaction to AOLTW's 1Q earnings release, Kiggen stayed quiet for a while. On May 22, AOL raised subscription rates for its AOL branded service. This step was widely expected, and would raise AOL's revenue and potentially EBITDA by $200M for the rest of 2001, and by $400M+ for 2002. CSFB wrote that "visibility on AOLTW meeting [its EBITDA] target ha[d] increased." CSFB raised its full-year AOLTW revenue estimate by $200M to $41.4B visibility and its EBITDA estimate to $11B.[14]

[12] These multiples are "12 month forward" multiples: They represent the multiple of 2001 earnings which Kiggen projected AOLTW would trade at 12 months hence. Multiples intended to reflect current prices would be lower by about 10%.

[13] It matter not much if the shortfall at AOL could -- somehow -- be made up on the TW side. For example, if TW made up half of the AOL shortfall, AOLTW value would rise by only about $1/share, because an EBITDA dollar on the TW side was worth much less than on the AOL side.

[14] CSFB Report, *AOL: Price Increase for AOL's Core Service; Raising Revenue and EBITDA* (May 22, 2001).

The next day, CSFB hosted an investor lunch with Robert Pittman, co-COO of AOLTW. Kiggen reported on the lunch as if AOLTW's ~~s~~ meeting its 2001 guidance was nearly a done deal:

> [I]t's clear that with the price increase, [AOLTW] is feeling comfortable about . . . its 2001 targets . . . . Management (and investors) will now increasingly focus on 2002 targets (our estimates are $47.4B in revenue, $13.7B in EBITDA).[15]

The 2002 EBITDA estimate was unchanged from the April 10 Report (that report does not provide a 2002 revenue estimate, but that was likely unchanged as well). Kiggen's and Martin's concerns with AOLTW's performance, expressed in March emails, could only have been confirmed by the weak 1Q 2001 results, yet remained out of public view.

After that, as the advertising slowdown continued and AOLTW's performance worsened, CSFB occasionally adjusted its public estimates downward, but never by much. It initially adjusted its revenue estimate for 2001; then, modestly, its revenue estimate for 2002; and eventually its estimate for 2001 EBITDA. Yet CSFB's price target remained stuck at $75, as if it had a life of its own, independent of the analysis which supposedly justified it.

On June 25, CSFB cut its revenue forecast for 2Q 2001 from $9.9B to $9.5B. But its 3Q, 4Q, and 2002 estimates were not changed, which left full year revenue at $41B. The EBITDA estimate was "kind of" unchanged for 2Q 2001 (AOLTW "should approach our EBITDA estimate of $2.6B, with a probable range of $2.5-2.6B) and unchanged after that.

Behind the scenes, Kiggen expected an even larger drop in AOL revenue for 2Q 2001, but compensated for this by raising estimated cable revenue, without justification and without Martin's

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[15] CSFB Report, *AOL: Pittman Meeting* (May 23, 2001).

concurrence.[16] The cable division then proceeded to come close to Martin's original estimate, and miss Kiggen's inflated estimate.

On July 10, a credible source in AOL's Business Affairs unit, which generated the lion's share of AOL's crucial Ad-Com Revenue, advised CSFB of "medium severity" layoffs in the unit, which would not be publicly announced. Ad-Com Revenue was the source of much of AOL's growth prospects and of AOLTW's market value. Substantial layoffs would be highly relevant to AOLTW's value, since they would lead investors to conclude that the business of selling online ads was weak, and that AOL expected continued weakness.

Also on July 10, this same source described an internal investigation into accounting irregularities. Kiggen appears not to have responded to these issues.

On July 18, 2001, AOLTW reported weak 2Q 2001 results. Revenue, in what should have been a cyclically strong quarter, was up only 1.3% versus the previous quarter to $9.2B, and only 3.3% versus the same quarter of the previous year, and well below Kiggen's estimate, even after the June reduction. As one news story put it, the "ad outlook" was the principal reason.[17] Results for EBITDA were not as bad as revenue, at $2,537. AOLTW retreated a bit from revenue guidance, saying now that $40B was the "top of the range", instead of a target it was "highly confident" of meeting, but reaffirmed its $11B EBITDA guidance. AOLTW's share price dropped about 10%, from $50 to $45.

On July 19, 2001, CSFB reduced 2H 2001 revenue, to a still unrealistic full-year estimate of $39.3B.[18] It left 2H estimates for EBITDA untouched, for a full year forecast of $10.9B (the prior

[16] Email from Laura Martin to Jamie Kiggen (Aug. 7, 2001).

[17] Reshma Kapadia, *AOL Shares drop 9.7% on Ad Outlook*, Toronto Star, July 19, 2001.

[18] CSFB's revised revenue forecast still required TW to rebound from a 2% year-over-year (2Q of 2001

forecast of $11B less the $100M shortfall in 2Q). Thus, CSFB was still projecting that AOLTW would meet its EBITDA guidance. CSFB also cut 2002 estimates for revenue and, ever so slightly, for EBITDA, but still projected 24% EBITDA growth in 2002, after 30% growth for 2001. These limited adjustments were not consistent with Kiggen's and Martin's private concerns about AOLTW, which had just been reinforced by its weak results.

On August 13, the *Wall Street Journal* reported significant expected layoffs at AOL, consistent with the information available to CSFB about layoffs at AOL's Business Affairs Unit.[19] CSFB's information was less specific as to number of employees but more specific about where the layoffs would occur. AOLTW's share price dropped by over 10% on Aug. 13-14. The price reaction is consistent with this information being highly important to investors.[20]

On August 15, CSFB finally abandoned its public view that AOLTW could meet its EBITDA guidance, reducing revenue and EBITDA estimates to $39B and $10.6B, with the reductions "coming primarily out of ad-driven businesses." CSFB didn't touch either its 2002 estimates or its $75 price target. It did not mention the news reports of layoffs.[21]

On September 25, AOLTW reduced its guidance for 2001 and 2002. The next day, Kiggen reduced his own estimates (he could hardly do otherwise), and finally adjusted his price target, which crashed from $75 to $45. So much for AOLTW's resilience in the face of an advertising slowdown.

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compared to 2Q of 2000) decline in revenue to a 3% year-over-year increase in 3Q and a 7% increase n 4Q 2001. This was inconsistent with Martin's internal concerns about TW, and was unlikely without a large, near-term improvement in economic conditions, which there was no basis for expecting.

[19] *AOL Time Warner to Cut Work Force at Online Unit*, Wall Street Journal, Aug. 13, 2001; Christopher Grimes, *AOL to Cut Up to 1,000 Online Jobs*, Financial Times, Aug. 15, 2001.

[20] News stories confirm that the layoffs, and related concerns with advertising revenue, contributed to the drop in AOLTW's share price. See, for example, David Lieberman, AOL Time Warner Stock Slips Amid Ad Worries, Layoff Talks, USA Today, Aug. 16, 2001.

[21] A separate CSFB Report on Aug. 22 discusses the layoffs, after AOLTW had publicly announced them.

## VII. Specific Responses to Prof. Deighton

### A. Prof. Deighton's Overall Questions

In Professor Deighton's report, he addresses two questions, giving "yes" answers to both:[22]

- Were the kinds of concerns that Laura Martin expressed in her internal e-mails about the advertising market and its potential impact on [AOLTW] between January and September 2001 . . . otherwise known to the public at the time?
- Was it reasonable for someone knowledgeable about the advertising market and AOL between January and September 2001 to have understood the kinds of concerns raised by Ms. Martin but have reached a more optimistic conclusion regarding AOL's prospects than Ms. Martin appear to have reached?

With regard to Prof. Deighton's second question, in my opinion, the appropriate question is not whether a hypothetical analyst might have been more optimistic than Ms. Martin concerning the prospects for AOL or for AOLTW as a whole; but instead whether CSFB's projections were consistent with her and Jamie Kiggen's actual beliefs and the actual information available to them and to CSFB.

In addition, the answers to his questions depend on when the question is asked -- an issue he does not address. What was reasonable in January 2001 might no longer be reasonable in February, after AOLTW released full year 2000 numbers. What was reasonable in February, when the online advertising market appeared soft but not terrible, might no longer be reasonable in March, when the outlook for online advertising had worsened. What was reasonable in March or April, before AOLTW released its 1Q 2001 numbers, might not be after that release. And so on.

One cannot assess an analyst's work or honesty in the abstract. One needs instead to assess the realism of particular forecasts at particular times, against the background of what was known about the online and traditional advertising markets, and how AOL had performed since the end of

[22] Deighton Report ¶ 6.

the NASDAQ bubble, and more specifically how it had performed in the first part of 2001. This is why my report is full of numbers, while the Deighton Report contains none.

Moreover, an analyst's job is to prepare his or her best estimates, based on all available information, not to publish an overly optimistic forecast, which the analyst does not in fact believe, and then only slowly, grudgingly, and partially modify that forecast as bad news comes in. That is true whether or not some other analyst, based on a different overall analysis, and different background views on the traditional and online advertising market, could reach a similar forecast.

What was reasonable for an AOL-centered analyst to believe was achievable for AOLTW as a whole, would also depend on the views of the TW-side analyst with whom he worked. Jamie Kiggen could not have reasonably said, "I don't like Laura Martin's numbers, so I'll invent my own." He could not reasonably have said, "AOL is missing its numbers, but I think AOLTW can make up the shortfall on the TW side and meet its overall guidance." He lacked the TW expertise to make that judgment.

Moreover, for CSFB's published reports, the "reasonableness" question to be asked is not whether one could reasonably be *more* optimistic than Laura Martin, but whether one could reasonably be *as optimistic as* CSFB's published reports were about AOL, or about AOLTW as a whole, *given* Martin's views on TW. My opinion, developed above, is no.

I agree with Prof. Deighton that there was general information available to investors about a decline in traditional advertising. There was also general information available about a slowdown in online advertising. However, that information was soft in early 2001, and hardened only as the year progressed. Moreover, that information was not monolithic. Some analysts expressed optimism in early 2001, especially about online advertising, as Prof. Deighton himself notes.

Moreover, AOLTW was saying, loudly and often, in effect, "The advertising slowdown is not affecting AOL." Then, a bit later on, AOLTW admitted some effect, but minimized it and expressed confidence that AOLTW would meet its guidance. For example, in December 2000, AOL Chairman Steve Case saw "no impact" on AOL from the demise of dot-coms or the "soft online advertising market."[23] In March 2001, AOLTW co-COO Robert Pittman publicly stated that AOLTW "was in good position, no matter what happens to the business cycle," and reiterated his confidence that AOLTW would meet its \$40B/\$11B guidance for revenue and EBITDA.[24] On May 22, 2001, CSFB hosted an investor lunch with Pittman, who reiterated his confidence in AOLTW's guidance, leading Kiggen to report on the lunch as if meeting 2001 guidance was a done deal. As late as July 12, 2001, a Business Week headline, based on interviews with AOL executives, read: "*AOL Asks: What Ad Bust?*"

Against that complex mix, with AOLTW repeatedly making optimistic statements, I believe that a clear view from CSFB's highly regarded analysts that "We don't buy AOLTW's story of near-immunity from economic trends" would have affected the overall mix of information available to investors about AOLTW, and would likely have affected its stock price.

**B. Subscription Revenue**

Prof. Deighton states that "[AOLTW] would be protected from this down cycle because of its heavy reliance on subscriptions."[25] This misunderstands the drivers of value for AOLTW. The largest driver of value was the AOL division, and within AOL, ads were the principal driver of growth, accounted for most of its profit, and for the lion's share of its market value. A subscription

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[23] Reshma Kapadia, *AOL's Case Sees Time Warner Deal By First Days 2001*, Reuters News, Dec. 20, 2000.

[24] *AOL Stands By Forecasts*, N.Y. Times, March 9, 2001.

[25] Deighton Report ¶ 22.

business, especially a maturing one, will not justify anything close to a 60x EBITDA multiple. This is all the more so because AOL's subscription business faced an important major medium-term competitive threat from broadband internet access.

On the TW side, CSFB's projections required rapid growth in 2001 and beyond, and that required growing ad revenue. Subscriptions provided a stable base, but other areas, including advertising, would drive most of the TW growth, and much of the TW value.

## C. Traditional Versus Online Advertising

Prof. Deighton says that the 2001 growth trends could be different for traditional and online advertising. I agree. He cites several estimates of continued growth in online advertising from January 2001, of 23%, 38%, and 59%.

Online advertising might indeed have been expected to grow as of January 2001, though with widely varying estimates of how fast. But that does not justify pie-in-the-sky estimates of AOL's Ad-Com Revenue growth, such as those for 4Q 2000 in the Fidelity Report, which were out of line with AOL's results for 2Q and 3Q 2000. It does not justify forecasts for AOL which were out of line with CSFB's own forecast for online advertising growth, which was only 8%. Table 7 reports data taken from the Fidelity Report, on Kiggen's estimates for AOL's Ad-Com Revenue, worldwide advertising revenue, AOL's share of total revenue, and AOL's share of total growth.

**Table 5: CSFB Estimates for Online Advertising (Jan. 2001)**

Amounts in $ millions. Y/Y growth is percentage growth in category for each year, versus the prior year. Estimates are from CSFB Report to Fidelity (Jan. xx, 2001). Ad-Com Revenue is "old series", before redefinition by AOLTW beginning with 4Q 2000.

| Item | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|---|
| AOL Ad-Com Revenue | 2,132 | 3,500 | 5,100 | 7,050 | 9,600 | 12,850 |
| *Y/Y growth* | | 64.2% | 45.7% | 38.2% | 36.2% | 33.9% |
| Worldwide online advertising | 8,000 | 8,640 | 10,800 | 13,824 | 17,280 | 21,427 |
| *Y/Y growth* | | 8.0% | 25.0% | 28.0% | 25.0% | 24.0% |
| AOL Share of Total | 26.7% | 40.5% | 47.2% | 51.0% | 55.6% | 60.0% |

| | | | | | | |
|---|---|---|---|---|---|---|
| *AOL Growth (share of total)* | | 213.8% | 74.1% | 64.5% | 73.8% | 78.4% |

These estimates, taken together, don't make sense. It was not plausible that AOL could grow its own ad revenue by 64%, if the market grew by only 8%. This implies that AOL would grow rapidly (far more rapidly than suggested by its' post-bubble results for 2Q and 3Q 2000, which was already implausible), while at the same time all other sources of online advertising fell.

Looking further out, it was implausible that AOL would capture 80% of the total worldwide growth in online advertising over the next five years. AOL, per its reported numbers, had captured a stunning 27% of online advertising in 2000, per Kiggen's estimate. But in a maturing market, one could not reasonably expect AOL to capture anywhere close to 80% of worldwide growth in online advertising over this extended period. It would be a great success, by no means assured, to maintain even their current market share.

Moreover, the outlook for online advertising had darkened by March 2001. By then, Henry Blodget, a highly rated internet analyst and internet bull at Merrill Lynch, was projecting a 25% decline; while CSFB was projecting a 20% decline. Kiggen's forecast, even if adjusted down a bit, implied that AOL would grow ad revenue in 2001 at 50% or more, while every else would see their online ad revenue shrink by 50%. That was implausible given CSFB's views of the overall online advertising market.

## IX. Specific Responses to Prof. Stulz

Most of Prof. Stulz's report addresses damages, stock price reactions on particular days, and whether CSFB's actual reports had a significant effect on market prices. These subjects are beyond the scope of my report. My opinions concern not the effect of the statements that CSFB's analysts made, but the potential effect of the statements it could have made, in accordance with Laura

Martin's more skeptical views. I address here only those opinions of Prof. Stulz that are concerned with the general advertising market and AOLTW's vulnerability to an advertising downturn.

**A. Investors' General Knowledge**

Prof. Stulz argues that investors knew in general of potential risks in both traditional and online advertising.[26] I agree. That general knowledge formed part of the overall mix of information that affected share prices. But so did more optimistic views, including AOLTW's own statements and the views of online advertising cited by Prof. Deighton.

Investors' general knowledge of risks would likely affect *by how* much their views would change, if CSFB had expressed a clear view contrary to AOLTW's oft-expressed confidence in meeting its guidance. Thus, that general knowledge is relevant to the amount of damages. Such a statement, by highly respected analysts, could still have, and in my opinion likely would have, significantly altered the total mix of information, and thus affected AOLTW's share price.

**B. Long-Term Growth and Terminal Multiples**

Prof. Stulz observes that whether the $75 target price for AOLTW, which CSFB maintained for much of 2001, could be justified through a DCF valuation depends on one's beliefs about long-term growth and terminal multiples.[27] However, those beliefs should be an analyst's honest beliefs, should be reasonable, and should change as the world changes. As I discuss above, in important respects, CSFB's projections for AOL were unreasonable in January 2001 and inconsistent with Martin's negative private views. Moreover, AOL's prospects deteriorated steadily over the course of 2001, and by March 2001, Jamie Kiggen also no longer believed CSFB's public statements. Yet

[26] Stulz Report ¶¶ 14-16.

[27] Stulz Report ¶ 28b.

CSFB did not reduce its target price until September 25, 2001, after AOLTW lowered its EBITDA guidance for 2001 and beyond.

**C. Risks and "Visibility"**

Prof. Stulz observes that "several of [CSFB's] reports" indicated risks to whether AOLTW would achieve its guidance, and some expressly mentioned the slowing ad market. Indeed they did. The degree of emphasis on risks or, as analysts sometimes refer to them, "visibility" concerns, varied. But the reports also contained projections that AOLTW would more than meet its guidance. Consider CSFB's revenue forecasts. For most of 1H 2001, Kiggen was projecting full year AOLTW revenue of $41.4 to $41.6B, well above AOLTW's guidance. And if revenue came in, EBITDA likely would have as well. As of July 18, 2001, when AOLTW released its weak 2Q results, he was still projecting $41B in revenue.

Investors would read CSFB's reports as a whole. They would not just consider the numbers, without the mention of risks. But neither would the mention of risks make the numbers unimportant. Kiggen and Martin were still, in the end, expressing a joint view that AOLTW would probably meet CSFB's above-guidance projections for 2001 revenue, and would continue to grow rapidly thereafter. A projection that mentions risks, but also expresses a view that AOLTW will more than meet its revenue guidance and will meet its EBITDA guidance for 2001,[28] and will grow very rapidly thereafter, is still very different than a clear statement, closer to Laura Martin's views, that the advertising market would affect them more strongly than they were publicly saying, and that they were unlikely to meet their own guidance.

[28] CSFB's guidance for EBITDA was often at $10.9B during Jan-May 2001 (excluding the likely increase in AOL subscription rates), was raised to $11B in May to reflect an increase in those rates, and reduced to $10.9B in July to reflect to 2Q 2001 shortfall in EBITDA. I view these estimates as essentially saying that AOLTW would meet its $11B guidance.

The mention of risks in CSFB's reports, like similar mentions in news stories and in reports by other analysts, once again goes to *by how much* a different Kiggen-Martin view would have affected share prices, and thus affects damages. A clear statement by highly respected analysts that AOLTW would be hurt by the advertising slowdown and would likely fail to meet its own guidance, which was Laura Martin's view as early as January 2001, could still have -- and I believe likely would have -- significantly affected investor views.

Executed this 17th day of July 2008 at Houston, Texas. I declare under penalty of perjury that the foregoing is true and correct.

Bernard S. Black

Bernard S. Black

# APPENDIX A

***Curriculum Vitae* of Bernard S. Black**